

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name CITY OF BENTON HARBOR, MICHIGAN	County BERRIAN
Fiscal Year End 06/30/06	Opinion Date 01/26/07	Date Audit Report Submitted to State	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

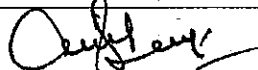
YES NO

Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☒ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☒ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☒ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) ALAN C YOUNG & ASSOCIATES, P.C.		Telephone Number (313) 873 7500	
Street Address 2990, W. GRAND BLVD., STE 310		City DETROIT	State MI
Zip 48202			
Authorizing CPA Signature 	Printed Name ANIL SAKHUJA	License Number 110102118	

City of Benton Harbor, Michigan

**Financial Report
with Supplemental Information
June 30, 2006**

City of Benton Harbor, Michigan

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City of Benton Harbor, Michigan

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INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and Members
of the City Commission
City of Benton Harbor, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Benton Harbor, Michigan as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Benton Harbor, Michigan's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Twin Cities Area Transportation Authority, which represents 98% of the assets and 97% of the revenue of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose report was furnished to us, and our opinion, insofar as it relates to the amounts included for the Transportation Authority, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provides a reasonable basis for our opinions.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Benton Harbor, Michigan as of June 30, 2006 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

To the Honorable Mayor and Members
of the City Council
City of Benton Harbor, Michigan

In accordance with Government Auditing Standards, we have also issued our report dated January 26, 2007 on our consideration of the City of Benton Harbor, Michigan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the result of our audit.

The management's discussion and analysis, the budgetary comparison schedule and pension system schedules of funding progress and employer contributions, as identified in the table of contents, are not a required part of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Benton Harbor, Michigan's basic financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The other supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Alan C. Young, Assoc.

January 26, 2007

City of Benton Harbor, Michigan

Management's Discussion and Analysis

The discussion and analysis of the City of Benton Harbor's financial performance provides an overview of the City's financial activities for the fiscal year ended June 30, 2006.

Management has prepared the financial statements and the related footnote disclosures along with the discussion and analysis. Responsibility for the completeness and fairness of this information rests with the City's management.

About the City of Benton Harbor

The City is located in Berrien County in the southwestern corner of the lower peninsula of Michigan. The City is governed by an elected nine-member commission, but operates under a manager form of government.

Because of its economically distressed status, in 1986 Benton Harbor was designated as an Enterprise Zone City by the State under the Michigan Enterprise Zone Act of 1985, and was in fact the only city in the state to receive such a designation. This designation allowed the City to redirect certain property tax collections as well as provide incentives for tax-base growth.

Under the Act, commercial/industrial businesses located within the City limits were given certain State tax benefits in return for real and personal property investments that increased taxable value. Organizations making this investment were then assessed property taxes at one-half the state-wide average millage rate (approximately 26 mills versus total local taxes of approximately 70 mills) for 10 years. The entire tax levy (26 mills) for these "certified" properties became revenue to the City's General Fund. As the 10-year benefit period expired for these organizations, the General Fund tax revenue reverted back to the 18 operating mills approved by City voters.

The remaining commercial/industrial businesses in the City electing not to become "certified" continued to pay property taxes at voter-approved millage rates. However, the Enterprise Zone Act allowed the City to recapture all local school district taxes. These taxes were reported as revenue in the Enterprise Zone Fund and restricted for capital/infrastructure expenditures to promote economic growth.

As "certified" businesses completed their 10-year certification period, General Fund revenue decreased as indicated above. Enterprise Zone Fund revenue increased due to the additional local school taxes recaptured on these properties.

The last commercial/industrial business certifications were approved in 1996 and the entire Enterprise Zone Act ended with property taxes levied in the City's June 30, 2005 fiscal year. Therefore, the year ended June 30, 2006 property tax revenue was generated at normal millage rates established and levied by all local taxing units.

City of Benton Harbor, Michigan

Management's Discussion and Analysis (Continued)

Using this Annual Report

This annual report consists of a series of financial statements. The statement of net assets and the statement of activities provide information about the activities of the City as a whole and present a longer-term view of the City's finances. This longer-term view uses the accrual basis of accounting so that it can measure the cost of providing services during the current year, and whether the taxpayers have funded the full cost of providing government services.

The fund financial statements present a short-term view; they tell us how the taxpayers' resources were spent during the year, as well as how much is available for future spending. Fund financial statements also report the City's operations in more detail than the government-wide financial statements by providing information about the City's most significant funds. The fiduciary fund statements provide financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the government.

City of Benton Harbor, Michigan

Management's Discussion and Analysis (Continued)

The City as a Whole

The following table shows, in a condensed format, the net assets as of the current date and compared to the prior two years:

Summary Condensed Statement of Net Assets (normally presented in thousands of dollars)

	Governmental Activities			Business-type Activities			Total		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
Current and other assets	\$ 4,187,835	\$ 3,388,071	\$ 2,846,575	\$ 9,968,775	\$ 9,632,799	\$ 9,733,441	\$ 14,156,610	\$ 13,020,870	\$ 12,580,016
Capital assets	16,438,820	15,635,750	12,984,809	3,645,048	3,330,733	3,255,087	20,083,868	18,966,483	16,239,896
Total assets	20,626,655	19,023,821	15,831,384	13,613,823	12,963,532	12,988,528	34,240,478	31,987,353	28,819,912
Current liabilities	4,051,763	1,511,063	1,257,135	1,182,446	582,194	747,431	5,234,209	2,093,257	2,004,566
Long-term liabilities	1,565,952	2,131,902	1,476,142	983,914	1,337,038	832,535	2,549,866	3,468,940	2,308,677
Total liabilities	5,617,715	3,642,965	2,733,277	2,166,360	1,919,232	1,579,966	7,784,075	5,562,197	4,313,243
Net assets:									
Invested in capital assets -									
Net of related debt	16,103,707	15,156,763	12,774,914	3,275,567	3,330,733	2,536,027	19,379,274	18,487,496	15,310,941
Restricted	3,592,990	3,721,874	2,446,001	321,823	-	-	3,914,813	3,721,874	2,446,001
Unrestricted (deficit)	(4,687,757)	(3,497,781)	(2,122,808)	7,850,073	7,713,567	8,872,535	3,162,316	4,215,786	6,749,727
Total net assets	<u>\$ 15,008,940</u>	<u>\$ 15,380,856</u>	<u>\$ 13,098,107</u>	<u>\$ 11,447,463</u>	<u>\$ 11,044,300</u>	<u>\$ 11,408,562</u>	<u>\$ 26,456,403</u>	<u>\$ 26,425,156</u>	<u>\$ 24,506,669</u>

The City's combined net assets remained flat compared to a year ago - increasing only \$31,247 from \$26,425,156 to \$26,456,403.

As we look at the governmental activities separately from the business-type activities, we can see that the net assets decreased 2.4 percent from a year ago. The deficit in unrestricted net assets - that which can be used to finance day-to-day operations - increased by approximately \$1,190,000 for the governmental activities.

Total net assets for the business-type activities increased approximately 3.7 percent while unrestricted net assets increased approximately 1.8 percent.

City of Benton Harbor, Michigan

Management's Discussion and Analysis (Continued)

The following table shows the changes in the net assets during the current year and as compared to the prior year:

	Governmental Activities			Business-type Activities			Total		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
Revenue									
Program revenue:									
Charges for services	\$ 1,102,854	\$ 1,087,217	\$ 1,030,753	\$ 4,956,929	\$ 4,037,964	\$ 3,841,195	\$ 6,059,783	\$ 5,125,181	\$ 4,871,948
Operating grants and contributions	2,543,149	2,276,232	2,117,561	-	-	-	2,543,149	2,276,232	2,117,561
Capital grants and contributions	549,436	957,101	93,101	-	402,495	305,098	549,436	1,359,596	398,199
General revenue:									
Property taxes	2,887,288	4,436,554	4,150,309	-	-	-	2,887,288	4,436,554	4,150,309
State-shared revenue	2,204,629	2,372,409	2,501,869	-	-	-	2,204,629	2,372,409	2,501,869
Unrestricted investment earnings	67,161	6,194	7,562	9,954	8,601	10,156	77,115	14,795	17,718
Franchise fees	45,035	-	-	-	-	-	45,035	-	-
Other revenue	141,725	-	-	-	-	-	141,725	-	-
Gain on sale of capital assets	1,589,127	690,486	132,475	-	-	-	1,589,127	690,486	132,475
Total revenue	11,130,404	11,826,193	10,033,630	4,966,883	4,449,060	4,156,449	16,097,287	16,275,253	14,190,079
Program Expenses									
General government	2,386,144	2,265,847	2,453,536	-	-	-	2,386,144	2,265,847	2,453,536
Public safety	4,707,799	3,844,815	3,461,988	-	-	-	4,707,799	3,844,815	3,461,988
Public works	2,294,646	2,201,606	2,001,357	-	-	-	2,294,646	2,201,606	2,001,357
Community and economic development	1,050,266	962,798	1,460,687	-	-	-	1,050,266	962,798	1,460,687
Recreation and culture	422,057	296,805	64,487	-	-	-	422,057	296,805	64,487
Interest on long-term debt	35,895	8,362	9,331	-	-	-	35,895	8,362	9,331
Water and sewer	-	-	-	4,946,366	4,568,227	4,205,429	4,946,366	4,568,227	4,205,429
Cemetery	-	-	-	222,867	208,306	203,798	222,867	208,306	203,798
Total program expenses	10,896,807	9,580,233	9,451,386	5,169,233	4,776,533	4,409,227	16,066,040	14,356,766	13,860,613
Excess (Deficiency) Before Transfers	233,597	2,245,960	582,244	(202,350)	(327,473)	(252,778)	31,247	1,918,487	329,466
Transfers In (Out)	(605,513)	36,789	33,036	605,513	(36,789)	(33,036)	-	-	-
Change in Net Assets	(371,916)	2,282,749	615,280	403,163	(364,262)	(285,814)	31,247	1,918,487	329,466
Beginning Net Assets	15,380,856	13,098,107	12,482,827	11,044,300	11,408,562	11,694,376	26,425,156	24,506,669	24,177,203
Ending Net Assets	\$ 15,008,940	\$ 15,380,856	\$ 13,098,107	\$ 11,447,463	\$ 11,044,300	\$ 11,408,562	\$ 26,456,403	\$ 26,425,156	\$ 24,506,669

City of Benton Harbor, Michigan

Management's Discussion and Analysis (Continued)

Governmental Activities

The City's total governmental revenues decreased by approximately \$696,000. The decrease, which represents approximately 6.0 percent, was primarily due to decreases in property taxes and grant revenue, offset by increases in the sale of capital assets.

Expenses increased by about \$1,316,000 during the year. Increases resulted from higher public safety, economic development, and recreation costs.

Business-type Activities

The City's business-type activities consist of utility service as well as cemetery operations. The City provides water to residents as well as sewage treatment services from the Benton Harbor/St. Joseph Joint Wastewater Treatment System.

Total revenues increased by \$518,000. The majority of this increase resulted from a mid-year increase in water rates charged and collected from customers. In addition, expenses increased approximately \$393,000 as the result of increases in water and sewer operating costs along with increases in salaries and health care expenses.

The City's Funds

Our analysis of the City's major funds begins on page 14, following the government-wide financial statements. The fund financial statements provide detail information about the most significant funds, not the City as a whole. The City Commission creates funds to help manage money for specific purposes as well as to show accountability for certain activities, such as special property tax millages. The City's major funds for 2006 include the General Fund, the Enterprise Zone Fund, the Debt Service Fund, and the Utility Service Fund.

The General Fund pays for most of the City's governmental services. Significant services include police and fire protection services, which incurred expenses of approximately \$4,650,000 in 2006.

The Enterprise Zone Fund pays for city-wide capital/infrastructure improvements from property tax revenue as required by the Michigan Enterprise Zone Act.

City of Benton Harbor, Michigan

Management's Discussion and Analysis (Continued)

General Fund Budgetary Highlights

The City did not amend its budget during the year.

Revenue shortfalls included \$250,000 in property taxes due to the phase-out of the Enterprise Zone Act, \$268,000 in shared revenue due to cutbacks by the State of Michigan, \$107,000 in rental income due to less equipment rentals, and \$96,000 in charges for services due to lower Jean Klock Park gate fees as well as rubbish collection fees. Total General Fund revenue fell short of budgeted amounts by approximately \$393,000.

On the expenditure side, mayor/commission and building and grounds exceeded budgeted amounts due to increased general liability/health insurance premiums and repairs and maintenance expenditures. Police department costs exceeded budget by almost 20 percent due to additional overtime costs, increased fringe benefit costs, and the significant rise in gasoline prices. Fire department costs exceeded budget for many of the same reasons. Rubbish collection fees continue to increase faster than the related revenue and exceeded budget by approximately \$58,000. Many other departments were at or below budget, which caused total General Fund expenditures to exceed budget by approximately \$506,000.

Capital Asset and Debt Administration

At the end of 2006, the City had approximately \$44,500,000 invested in a broad range of capital assets, including buildings, police and fire equipment, water and sewer lines, and streets and sidewalks. This amount included additions of \$2,250,000 during the year. In addition, the City has invested significantly in roads within its boundaries. Infrastructure projects in progress and/or completed in 2006 amounted to \$1,500,000 and are included in the additions above. This was after an investment of \$2,300,000 in 2005. Retroactive infrastructure to 1980 will be reported no later than June 30, 2007.

The City incurred additional debt in fiscal 2006 for equipment and economic development totaling \$925,000. A promissory note in the amount of \$1,250,000 was signed by the City and Benton Charter Township to cover remittance of past water collections by the City from Township residents. This note requires monthly payments through July 2009.

In 2005, the City made the final payment on all Michigan Emergency Loans. These loans, totaling \$2,440,000, were issued in 1981 through 1985 to bring some financial stability to the City. While the City still struggles financially, all loan payments were made timely. The payoff of these emergency loans in 2005 allowed the City to allocate \$125,000 of available governmental fund revenue toward the annual debt service requirement of the Utility Service Fund water bonds in 2006.

City of Benton Harbor, Michigan

Management's Discussion and Analysis (Continued)

Economic Factors and Next Year's Budgets and Rates

As discussed earlier, the final phase-out of the Enterprise Zone Act at June 30, 2005 will significantly reduce General Fund and Enterprise Zone Fund tax revenue. Starting in fiscal 2006, the Enterprise Zone Fund no longer received property taxes (other than delinquent collections) and activity in this fund was limited to using existing fund balance. The City is exploring alternate ways to fund capital/infrastructure improvements required for continued economic growth.

The economic position of the City is closely tied to that of the State. For fiscal year 2006, the State revenue sharing provided 34 percent of the City's General Fund revenues (excluding the sale of City-owned property). The State continues to reduce statutory revenue sharing to all local units of government. The State's budget for its year beginning October 1, 2006 contained an agreement for the cities, villages, and townships to maintain revenue-sharing funding at prior year level. However, this very likely could change. The State funding problems are believed to be a multiple-year situation and future decreases may be likely.

As property tax revenue and state revenue sharing decrease, controlling General Fund expenditures becomes a significant challenge unless new revenue can be generated. The City continues to look for ways to increase its tax base to generate more property tax revenue. Sales of tax-reverted properties for the Harbor Shores initiative (discussed below) generated \$970,000 of General Fund revenue in 2006 and will provide additional tax base in the future. The court challenge resolved favorably in 2005 related to the sale of a parcel of Jean Klock Park for residential development provided approximately \$557,000 of revenue in 2006 from additional lot sales. This entire parcel will be developed into 27 high-income residential lots. As lots are sold, the City is entitled to receive 75 percent of the sales price, which will range from \$100,000 to \$400,000 per lot. It is anticipated that lot sales will occur over the next two to three years. Infrastructure for two more residential developments was completed in 2006. The Harbor Town subdivision will consist of 26 houses built for middle-income families and the \$20 million HOPE VI housing project will provide replacement low-income housing. As construction is completed, these properties will add significant dollars to the City's property tax base over the next five years.

To facilitate the above projects, the City incurred significant up-front costs in fiscal 2005 and 2006. This investment, which will not be returned for several years, consisted mostly of infrastructure such as replacement of water mains in the Belview/Brunson Avenue area, replacement of the Stevens Avenue sewer lift station, demolition and replacement of the North Shore Drive bridge, reconstruction/resurfacing of Colfax, Broadway, and Pipestone Avenues, and recreation area improvements including Riverfront Park and a new bike path connecting points of interest throughout the City. The Paw Paw River Bridge was completed and opened in December 2005 and provides another traffic connection between the cities of Benton Harbor and St. Joseph.

City of Benton Harbor, Michigan

Management's Discussion and Analysis (Continued)

Economic Factors and Next Year's Budgets and Rates (Continued)

A major economic development effort which involves not only the City of Benton Harbor, but also the City of St. Joseph and Benton Charter Township, will begin in late fiscal 2007 or early fiscal 2008. The Harbor Shores initiative will include development in the areas of water and land recreation facilities, residential housing, retail trade, and arts and culture opportunities. When complete, this project could triple the City's existing tax base over the next five years.

Contacting the City's Management

This financial report is intended to provide our citizens, taxpayers, customers, and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional information, we welcome you to contact the city manager, Dwight P. Mitchell, at 200 E. Wall Street, Benton Harbor, Michigan 49022.

City of Benton Harbor, Michigan

Statement of Net Assets June 30, 2006

	Primary Government			
	Governmental	Business-type	Total	Component
	Activities	Activities		Units
Assets				
Cash and cash equivalents	\$ 1,581,086	\$ 132,082	\$ 1,713,168	\$ 14,374
Receivables (Note 4)	380,717	1,401,322	1,782,039	208,127
Internal balances	1,303,613	(1,303,613)	-	-
Prepaid expenses and other assets	-	81,719	81,719	69,643
Restricted assets	-	321,823	321,823	-
Investment in joint ventures	77,127	9,323,373	9,400,500	-
Due from other governmental units	347,856	-	347,856	-
Notes receivable	497,435	-	497,435	-
Capital assets (Note 5):				
Assets not subject to depreciation	3,693,232	6,736	3,699,968	62,700
Assets subject to depreciation	12,745,588	3,638,312	16,383,900	873,442
Intangible assets	-	12,068	12,068	-
Total assets	20,626,654	13,613,822	34,240,476	1,228,286
Liabilities				
Accounts payable	1,679,765	177,811	1,857,576	128,457
Due to other governmental units	1,373,431	-	1,373,431	-
Refundable deposits, bonds, etc.	-	129,655	129,655	-
Accrued liabilities and other	294,537	93,520	388,057	-
Noncurrent liabilities (Note 8) -				
Due within one year:				
Compensated absences	340,942	84,092	425,034	-
Net pension obligation	133,760	59,967	193,727	-
Current portion of long-term debt	229,327	637,400	866,727	-
Due in more than one year:				
Compensated absences - > 1 yr	60,166	4,426	64,592	-
Long-term debt - Net of current portion	1,505,786	979,488	2,485,274	-
Total liabilities	5,617,714	2,166,359	7,784,073	128,457
Net Assets				
Invested in capital assets - Net of related debt	16,103,707	3,275,567	19,379,274	936,142
Restricted for:				
Debt service	1,186,742	-	1,186,742	-
Other purposes	2,406,248	321,823	2,728,071	-
Unrestricted	(4,687,757)	7,850,073	3,162,316	163,687
Total net assets	\$ 15,008,940	\$ 11,447,463	\$ 26,456,403	\$ 1,099,829

The Notes to Financial Statements are an
Integral Part of this Statement.

City of Benton Harbor, Michigan

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary government:				
Governmental activities:				
General government	\$ 2,386,144	\$ 393,403	\$ 249,451	\$ -
Public safety:				
Police and fire	4,493,509	71,039	511,124	-
Building inspections	214,290	-	-	-
Public works	2,294,646	520,380	816,705	-
Community and economic development	1,050,266	-	949,687	549,436
Recreation and culture	422,057	118,032	16,182	-
Interest on long-term debt	35,895	-	-	-
Total governmental activities	10,896,807	1,102,854	2,543,149	549,436
Business-type activities:				
Utility service	4,946,366	4,808,105	-	-
Cemetery	222,867	148,824	-	-
Total business-type activities	5,169,233	4,956,929	-	-
Total primary government	<u>\$ 16,066,040</u>	<u>\$ 6,059,783</u>	<u>\$ 2,543,149</u>	<u>\$ 549,436</u>
Component units:				
Twin Cities Transportation Authority	\$ 1,740,721	\$ 228,351	\$ 1,124,436	\$ 221,392
Brownfield Redevelopment	99,136	-	-	17,374
Total component units	<u>\$ 1,839,857</u>	<u>\$ 228,351</u>	<u>\$ 1,124,436</u>	<u>\$ 238,766</u>
General revenues:				
Property taxes				
State shared revenue				
Unrestricted investment income				
Cable franchise fees				
Miscellaneous				
Total general revenues				
Sale of fixed assets				
Transfers				
Change in Net Assets				
Net Assets - Beginning of year				
Net Assets - End of year				

Statement of Activities
Year Ended June 30, 2006

Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
\$ (1,743,290)	\$ -	\$ (1,743,290)	\$ -
(3,911,346)	-	(3,911,346)	-
(214,290)	-	(214,290)	-
(957,561)	-	(957,561)	-
448,857	-	448,857	-
(287,843)	-	(287,843)	-
(35,895)	-	(35,895)	-
(6,701,368)	-	(6,701,368)	-
-	(138,261)	(138,261)	-
-	(74,043)	(74,043)	-
-	(212,304)	(212,304)	-
(6,701,368)	(212,304)	(6,913,672)	-
-	-	-	(166,542)
-	-	-	(81,762)
-	-	-	(248,304)
2,887,288	-	2,887,288	153,391
2,204,629	-	2,204,629	-
67,161	9,954	77,115	2,714
45,035	-	45,035	-
141,725	-	141,725	-
5,345,838	9,954	5,355,792	156,105
1,589,127	-	1,589,127	12,075
(605,513)	605,513	-	-
(371,916)	403,163	31,247	(80,124)
15,380,856	11,044,300	26,425,156	1,179,953
\$ 15,008,940	\$ 11,447,463	\$ 26,456,403	\$ 1,099,829

City of Benton Harbor, Michigan

Governmental Funds Balance Sheet June 30, 2006

	General Fund	Enterprise Zone	Debt Service	Nonmajor Funds	Total
Assets					
Cash and cash equivalents	\$ 529,115	\$ 987,800	\$ 2,324	\$ 61,847	\$ 1,581,086
Receivables - Net	380,717	-	-	-	380,717
Due from other funds	1,256,240	-	-	-	1,256,240
Advances to other funds	381,764	1,698,699	1,184,418	1,095,987	4,360,868
Due from other governmental units	131,401	66,745	-	149,710	347,856
Notes receivable	53,588	443,847	-	-	497,435
Total assets	<u>\$ 2,732,825</u>	<u>\$ 3,197,091</u>	<u>\$ 1,186,742</u>	<u>\$ 1,307,544</u>	<u>\$ 8,424,202</u>
Liabilities and Fund Balances					
Liabilities					
Accounts payable	\$ 1,066,791	\$ 288,170	\$ -	\$ 324,804	\$ 1,679,765
Due to other governmental units	852,771	520,660	-	-	1,373,431
Due to other funds	-	-	-	110,544	110,544
Advances from other funds	3,415,811	-	-	787,140	4,202,951
Accrued liabilities and other	227,468	-	-	67,069	294,537
Deferred revenue	-	443,847	-	-	443,847
Total liabilities	5,562,841	1,252,677	-	1,289,557	8,105,075
Fund Balances					
Reserved for:					
Advances	381,764	1,698,699	1,184,418	1,095,987	4,360,868
Long-term receivables	53,588	-	-	-	53,588
Restricted contribution	-	211,200	-	-	211,200
Unreserved, reported in:					
General Fund	(3,265,368)	-	-	-	(3,265,368)
Debt Service Funds	-	-	2,324	-	2,324
Special Revenue Funds	-	34,515	-	(1,078,473)	(1,043,958)
Capital Projects Funds	-	-	-	473	473
Total fund balances	<u>(2,830,016)</u>	<u>1,944,414</u>	<u>1,186,742</u>	<u>17,987</u>	<u>319,127</u>
Total liabilities and fund balances	<u>\$ 2,732,825</u>	<u>\$ 3,197,091</u>	<u>\$ 1,186,742</u>	<u>\$ 1,307,544</u>	<u>\$ 8,424,202</u>

City of Benton Harbor, Michigan

Governmental Funds **Reconciliation of the Balance Sheet to the Statement of Net Assets** **Year Ended June 30, 2006**

Fund Balance Reported in Governmental Funds	\$	319,127
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and are not reported in the funds		16,438,820
Investments in joint ventures are not financial resources and are not reported in the funds		77,127
Special assessment receivables are expected to be collected over several years and are not available to pay for current year expenditures		443,847
Bonds payable and capital lease obligations are not due and payable in the current period and are not reported in the funds		(1,735,113)
Employee compensated absences are payable over a long period of years and do not represent a claim on current financial resources; therefore, they are not reported as fund liabilities		(401,108)
Net pension obligation does not represent a claim on current resources; therefore, it is not reported as a fund liability		(133,760)
Net Assets of Governmental Activities	\$	<u>15,008,940</u>

City of Benton Harbor, Michigan

Governmental Funds

Statement of Revenue, Expenditures, and Changes in Fund Balances

Year Ended June 30, 2006

	General Fund	Enterprise Zone	Debt Service	Nonmajor Funds	Total
Revenue					
Property taxes	\$ 2,176,981	\$ 118,856	\$ 433,825	\$ 157,626	\$ 2,887,288
Licenses and permits	64,857	-	-	-	64,857
Federal grants	430,191	549,436	-	1,092,495	2,072,122
State-shared revenue and grants	2,301,744	-	-	841,314	3,143,058
Other local donations	249,451	-	-	-	249,451
Other charges for services	531,730	-	-	-	531,730
Charges to other funds	175,000	-	-	-	175,000
Other fines and forfeitures	195,786	-	-	-	195,786
Investment income	5,832	60,827	13	489	67,161
Rental income	135,482	-	-	-	135,482
Other revenue:					
Cable franchise fees	45,035	-	-	-	45,035
Other miscellaneous income	106,310	34,536	-	33,181	174,027
Total revenue	6,418,399	763,655	433,838	2,125,105	9,740,997
Expenditures					
General government	2,279,980	-	-	-	2,279,980
Public safety	4,657,281	-	-	-	4,657,281
Public works	1,062,586	-	-	1,111,039	2,173,625
Community and economic development	225,223	1,226,689	-	1,061,276	2,513,188
Recreation and culture	216,879	-	-	-	216,879
Total expenditures	8,441,949	1,226,689	-	2,172,315	11,840,953
Excess of Revenue Over (Under) Expenditures	(2,023,550)	(463,034)	433,838	(47,210)	(2,099,956)
Other Financing Sources (Uses)					
Face value of debt issue	-	900,000	-	-	900,000
Sale of fixed assets	1,589,127	-	-	-	1,589,127
Transfers in	36,875	-	-	-	36,875
Transfers out	-	(437,570)	(204,818)	-	(642,388)
Total other financing sources (uses)	1,626,002	462,430	(204,818)	-	1,883,614
Net Change in Fund Balance	(397,548)	(604)	229,020	(47,210)	(216,342)
Fund Balance (Deficit) - Beginning of year	(2,432,468)	1,945,018	957,722	65,197	535,469
Fund Balance (Deficit) - End of year	<u>\$ (2,830,016)</u>	<u>\$ 1,944,414</u>	<u>\$ 1,186,742</u>	<u>\$ 17,987</u>	<u>\$ 319,127</u>

The Notes to Financial Statements are an
Integral Part of this Statement.

City of Benton Harbor, Michigan

Governmental Funds Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balance of Governmental Funds to the Statement of Activities Year Ended June 30, 2006

Net Change in Fund Balances - Total Governmental Funds \$ (216,342)

Amounts reported for governmental activities in the statement
of activities are different because:

Governmental funds report capital outlays as expenditures;
however, in the statement of activities, these costs are
allocated over their estimated useful lives as depreciation:

Capital outlay	1,637,297
Depreciation expense	(834,227)

Revenues are recorded in the statement of activities when earned; they are not reported in the funds until collected or collectible within 60 days of year end	(226,583)
--	-----------

Bond proceeds provide financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets	(900,000)
--	-----------

The government's investment in its joint venture is not a financial resource, and therefore the change in the investment is not reported in the funds	23,163
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Repayment of bond principal is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt)	343,874
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Accrued interest expense is not due and payable in the current period and therefore is not reported in the funds	3,694
---	-------

Increase in accumulated employee sick and vacation pay and other similar expenses reported in the statement of activities do not require the use of current resources, and therefore are not reported in the fund statements until they come due for payment	(69,032)
--	----------

Annual required pension contributions not paid do not require the use of current resources and therefore are not reported in the fund statements until they are paid	(133,760)
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Change in Net Assets of Governmental Activities \$ (371,916)

City of Benton Harbor, Michigan

Proprietary Funds Statement of Net Assets June 30, 2006

	Enterprise Funds		
	Utility Service	Cemetery	Total
Assets			
Current assets:			
Cash and cash equivalents	\$ 132,038	\$ 44	\$ 132,082
Receivables - Net (Note 4)	1,401,322	-	1,401,322
Prepaid expenses and other assets	12,573	69,146	81,719
Total current assets	1,545,933	69,190	1,615,123
Noncurrent assets:			
Restricted assets	-	321,823	321,823
Advances to other funds	34,758	-	34,758
Investment in joint ventures	9,323,373	-	9,323,373
Capital assets (Note 5)	3,601,643	43,405	3,645,048
Intangible assets - Net	12,068	-	12,068
Total noncurrent assets	12,971,842	365,228	13,337,070
Total assets	14,517,775	434,418	14,952,193
Liabilities			
Current liabilities:			
Accounts payable	164,353	13,458	177,811
Due to other funds	1,145,696	-	1,145,696
Refundable deposits, bonds, etc.	129,655	-	129,655
Accrued liabilities and other	89,345	4,175	93,520
Compensated absences (Note 8)	55,205	28,887	84,092
Net pension obligation	59,967	-	59,967
Current portion of long-term debt (Note 8)	619,037	18,363	637,400
Total current liabilities	2,263,258	64,883	2,328,141
Noncurrent liabilities :			
Advances from other funds	-	192,675	192,675
Compensated absences - > 1 yr (Note 8)	2,906	1,520	4,426
Long-term debt - Net of current portion (Note 8)	964,964	14,524	979,488
Total noncurrent liabilities	967,870	208,719	1,176,589
Total liabilities	3,231,128	273,602	3,504,730
Net Assets			
Invested in capital assets - Net of related debt	3,265,049	10,518	3,275,567
Restricted:			
Perpetual care	-	321,823	321,823
Advances	34,758	-	34,758
Unrestricted	7,986,840	(171,525)	7,815,315
Total net assets	\$ 11,286,647	\$ 160,816	\$ 11,447,463

City of Benton Harbor, Michigan

Proprietary Funds Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2006

	Enterprise Funds		
	Utility Service	Cemetery	Total
Operating Revenue			
Sale of water	\$ 3,020,216	\$ -	\$ 3,020,216
Sewage disposal charges	1,166,995	-	1,166,995
Other sales to customers	180,994	148,074	329,068
Interest and penalty charges	104,328	-	104,328
Other miscellaneous revenues	50	750	800
Total operating revenue	4,472,583	148,824	4,621,407
Operating Expenses			
Cost of water	3,283,237	-	3,283,237
Cost of sewage treatment	754,256	-	754,256
Other operation and maintenance costs	-	203,729	203,729
Billing and administrative costs	591,558	-	591,558
Depreciation	279,058	16,349	295,407
Total operating expenses	4,908,109	220,078	5,128,187
Operating Loss	(435,526)	(71,254)	(506,780)
Nonoperating Revenue (Expenses)			
Investment income	-	9,954	9,954
Income from joint venture	335,523	-	335,523
Interest expense	(24,818)	(2,789)	(27,607)
Amortization of bond issuance costs	(13,440)	-	(13,440)
Loss - Before transfers	(138,261)	(64,089)	(202,350)
Transfers In	623,658	-	623,658
Transfers Out	(18,145)	-	(18,145)
Change in Net Assets	467,252	(64,089)	403,163
Net Assets - Beginning of year	10,819,395	224,905	11,044,300
Net Assets - End of year	<u>\$ 11,286,647</u>	<u>\$ 160,816</u>	<u>\$ 11,447,463</u>

City of Benton Harbor, Michigan

Proprietary Funds Statement of Cash Flows Year Ended June 30, 2006

	Utility Service	Cemetery	Total
Cash Flow from Operating Activities			
Receipts from customers	\$ 4,295,647	\$ 148,924	\$ 4,444,571
Receipts from interfund services and reimbursements	11,150	39,795	50,945
Payments to suppliers	(2,612,415)	(19,660)	(2,632,075)
Payments to employees	(1,641,909)	(162,594)	(1,804,503)
Net cash provided by operating activities	52,473	6,465	58,938
Cash Flows from Noncapital Financing Activities			
Issuance of debt for operating purposes	-	25,216	25,216
Transfers from other funds	623,658	-	623,658
Principal and interest paid on operating debt	-	(15,684)	(15,684)
Transfers to other funds	(18,145)	-	(18,145)
Net cash provided by noncapital financing activities	605,513	9,532	615,045
Cash Flows from Capital and Related Financing Activities			
Purchase of capital assets	(584,506)	(25,216)	(609,722)
Principal and interest paid on capital debt	(186,214)	-	(186,214)
Net cash used in capital and related financing activities	(770,720)	(25,216)	(795,936)
Cash Flows from Investment Activities			
Interest received on investments	-	9,954	9,954
Purchase of investment securities	-	(9,719)	(9,719)
Net cash provided by investing activities	-	235	235
Net Decrease in Cash and Cash Equivalents	(112,734)	(8,984)	(121,718)
Cash and Cash Equivalents - Beginning of year	244,772	9,028	253,800
Cash and Cash Equivalents - End of year	<u>\$ 132,038</u>	<u>\$ 44</u>	<u>\$ 132,082</u>
Reconciliation of Operating Loss to Net Cash from Operating Activities			
Operating loss	\$ (435,526)	\$ (71,254)	\$ (506,780)
Adjustments to reconcile operating loss to net cash from operating activities:			
Depreciation and amortization	279,058	16,349	295,407
Changes in assets and liabilities:			
Receivables	(157,505)	100	(157,405)
Prepaid and other assets	(19,431)	-	(19,431)
Accounts payable	(373,174)	10,361	(362,813)
Due to other funds	11,150	39,795	50,945
Accrued and other liabilities	95,861	416	96,277
Due to others	577,891	-	577,891
Compensated absences	14,182	10,698	24,880
Net pension obligation	59,967	-	-
Net cash provided by operating activities	<u>\$ 52,473</u>	<u>\$ 6,465</u>	<u>\$ 58,938</u>
Noncash Transactions - Due to other governmental units converted to note payable	<u>\$ 1,247,407</u>	<u>\$ -</u>	<u>\$ 1,247,407</u>

The Notes to Financial Statements are an
Integral Part of this Statement.

City of Benton Harbor, Michigan

Fiduciary Funds **Statement of Fiduciary Net Assets - Pension Trust Funds** **June 30, 2006**

Assets

Cash and cash equivalents	\$ 20,955
Investments:	
Mutual funds	8,262,272
U.S. government securities	702
Corporate securities	7,337,541
Foreign stocks	420,384
Receivables	909,466
Accrued interest receivable	<u>36,173</u>
Total assets	16,987,493

Liabilities - Due to resigned employees	<u>6,189</u>
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Net Assets Held in Trust for Pension and Other Employee Benefits	<u>\$ 16,981,304</u>
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City of Benton Harbor, Michigan

Fiduciary Funds Statement of Changes in Fiduciary Net Assets Pension Trust Funds Year Ended June 30, 2006

Additions

Investment income:	
Interest and dividends	\$ 1,026,121
Net increase in fair value of investments	<u>36,951</u>
Net investment income	1,063,072
Contributions:	
Employer	389,230
Employee	<u>215,588</u>
Total contributions	604,818
Property taxes	<u>257,239</u>
Total additions	1,925,129

Deductions

Benefit payments	1,173,680
Administrative expenses	<u>64,062</u>
Total deductions	<u>1,237,742</u>

Net Increase in Net Assets Held in Trust 687,387

Net Assets Held in Trust for Pension and Other Employee Benefits - Beginning of year 16,293,917

Net Assets Held in Trust for Pension and Other Employee Benefits - End of year \$ 16,981,304

City of Benton Harbor, Michigan

Component Units Statement of Net Assets (Deficit) June 30, 2006

	Twin Cities Transportation Authority*	Brownfield Redevelopment Authority	Total
Assets			
Cash and cash equivalents	\$ 14,374	\$ -	\$ 14,374
Receivables	184,277	23,850	208,127
Prepaid expenses and other assets	69,643	-	69,643
Capital assets	936,142	-	936,142
Total assets	1,204,436	23,850	1,228,286
Liabilities - Accounts payable	92,782	35,675	128,457
Net Assets (Deficit)			
Invested in capital assets - Net of related debt	936,142	-	936,142
Unrestricted	175,512	(11,825)	163,687
Total net assets (deficit)	<u>\$ 1,111,654</u>	<u>\$ (11,825)</u>	<u>\$ 1,099,829</u>

* The Twin Cities Transportation Authority is presented as of its fiscal year end, September 30, 2005.

City of Benton Harbor, Michigan

		Program Revenues		
		Charges for	Operating	Capital Grants
	Expenses	Services	Grants and	and
			Contributions	Contributions
Functions/Programs				
Twin Cities Transportation Authority - Public works*	\$ 1,740,721	\$ 228,351	\$ 1,124,436	\$ 221,392
Brownfield Redevelopment Authority - Community and economic development	99,136	-	-	17,374
Total governmental activities	<u>\$ 1,839,857</u>	<u>\$ 228,351</u>	<u>\$ 1,124,436</u>	<u>\$ 238,766</u>
General revenues:				
Property taxes				
Unrestricted investment income				
Total general revenues				
Sale of fixed assets				
Change in Net Assets				
Net Assets (Deficit) - Beginning of year				
Net Assets (Deficit) - End of year				

* The Twin Cities Transportation Authority is presented as of its fiscal year end, September 30, 2005.

**Component Units
Statement of Activities
Year Ended June 30, 2006**

<u>Net (Expense) Revenue and Changes in Net Assets</u>		
<u>Twin Cities Transportation Authority</u>	<u>Brownfield Redevelopment Authority</u>	<u>Total</u>
\$ (166,542)	\$ -	\$ (166,542)
<u>-</u>	<u>(81,762)</u>	<u>(81,762)</u>
(166,542)	(81,762)	(248,304)
78,296	75,095	153,391
<u>2,714</u>	<u>-</u>	<u>2,714</u>
81,010	75,095	156,105
<u>12,075</u>	<u>-</u>	<u>12,075</u>
(73,457)	(6,667)	(80,124)
<u>1,185,111</u>	<u>(5,158)</u>	<u>1,179,953</u>
<u>\$ 1,111,654</u>	<u>\$ (11,825)</u>	<u>\$ 1,099,829</u>

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note I - Nature of Business and Significant Accounting Policies

The accounting policies of the City of Benton Harbor (the "City") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City of Benton Harbor.

Reporting Entity

The City of Benton Harbor is governed by an elected nine-member commission. The accompanying financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Although blended component units are legal separate entities, in substance, they are part of the City's operations. Each discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the City (see discussion below for description).

Blended Component Units - The City of Benton Harbor blends one component unit, the Economic Development Corporation (the "Corporation"). The Corporation was established to encourage the location and expansion of industrial/commercial enterprises within the City limits on the City's behalf. The City provides all administrative functions of the Corporation and appoints two commission members to the Corporation's nine-member board. The Economic Development Corporation has been blended with the City's Special Revenue Funds and is considered a nonmajor fund.

Discretely Presented Component Units - The City discretely presents two component units in these financial statements, the Twin Cities Area Transportation Authority (the "Transportation Authority"), and the Brownfield Redevelopment Authority.

The Transportation Authority was incorporated in the State of Michigan on July 1, 1974 under Public Act 55 of 1963. The purpose of the Authority is to acquire, own, operate, and manage a public transportation system within the boundaries of the City of Benton Harbor, its only participating municipality. Given that the City has significant influence over the Authority and is the only participating municipality, the Twin Cities Area Transportation Authority is a component unit of the City of Benton Harbor. The Twin Cities Area Transportation Authority is, for financial purposes within generally accepted accounting principles, an Enterprise Fund of the City of Benton Harbor. A complete financial report can be obtained from the Twin Cities Area Transportation Authority at 275 East Wall Street, Benton Harbor, MI 49023-0837, telephone (269) 927-2268.

The Brownfield Redevelopment Authority (the "Authority") was established pursuant to Act 381 of the Public Acts of 1996, as amended. The purpose of the Authority is to treat and revitalize environmentally distressed brownfield zones. The Authority's budget is subject to approval by the City Commission.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note I - Nature of Business and Significant Accounting Policies (Continued)

Jointly Governed Organization

Southwest Michigan Regional Airport Authority - In fiscal 1998, four municipalities approved the establishment of an Airport Authority to oversee airport operations. Operations are partially funded by property taxes. In late July 1998, control of airport operations was transferred to the Authority. The Authority is governed by a board of four members, including one from each participating municipality. Upon dissolution, net assets will be shared on a pro rata basis based on amounts contributed to the Authority. The City's equity share was 4.9 percent at June 30, 2006. Based on audited financial statements, an equity interest has been recorded in the City's basic financial statements as a governmental activity.

Benton Harbor-St. Joseph Joint Sewage Disposal Plant - The City is a participant with the City of St. Joseph in a joint venture to provide sanitary sewage treatment and collection facilities for the residents of these communities. The Benton Harbor-St. Joseph Joint Wastewater Treatment Plant was created for that purpose. Upon dissolution of the plant, the net assets will be shared on an equal basis with the City of St. Joseph. The plant is governed by a board of eight members consisting of three members each from Benton Harbor and St. Joseph and two members chosen from neighboring communities. The City's net investment and its share of the operating results of the plant are reported in the City's Utility Services Fund (a business-type activity).

"Corridor" Corporation - The City of Benton Harbor formed a development corporation with Cornerstone Alliance (Cornerstone), a nonprofit organization established to promote economic growth in Benton Harbor and surrounding communities. The intent of this organization is to promote economic development in the "Benton Harbor Airport Corridor." The entity is owned 50 percent by the City and 50 percent by Cornerstone. The City contributed City-owned property to the corporation. Cornerstone Alliance has incurred expenses on behalf of this corporation totaling \$117,650. These amounts are reflected as accounts receivable on Cornerstone's records, repayment which is dependent on future development of property held by the "Corridor" Corporation. The only significant activity in the "Corridor" Corporation to date is the contribution of the property. In the future, when development activity begins, this investment will be accounted for on the equity method.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note I - Nature of Business and Significant Accounting Policies (Continued)

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation - The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund, fiduciary fund, and component unit financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note I - Nature of Business and Significant Accounting Policies (Continued)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. The following major revenue sources meet the availability criterion: state-shared revenue, state gas and weight tax revenue, and interest associated with the current fiscal period. Conversely, special assessments and federal grant reimbursements will be collected after the period of availability; receivables have been recorded for these, along with a "deferred revenue" liability.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

The City reports the following major governmental funds:

- The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.
- The Enterprise Zone is a Special Revenue Fund that accounts for property taxes provided by the Michigan Enterprise Zone Act that are restricted for capital/infrastructure improvements.
- The Debt Service Fund accounts for the resources accumulated and payments made for principal and interest on long-term general obligation debt of the governmental funds.

The City reports the following major proprietary fund:

- The Utility Services Fund accounts for the activities of the City's water distribution and wastewater treatment systems.

Additionally, the City reports the following fund types:

- Special Revenue Funds account for revenue sources that are legally restricted to expenditures for specific purposes not including capital projects or permanent funds.
- The Permanent Fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support specified government programs.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

- The Pension Trust Funds account for the activities of both the general employees and police and fire employees retirement systems, which accumulates resources for pension benefit payments to qualified employees.

Private sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The City has elected not to follow private sector standards issued after November 30, 1989 for its business-type activities.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's water and sewer function and various other functions of the City. Eliminations of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenue include: (1) charges to customers or applicants for goods, services, or privileges provided; (2) operating grants and contributions; and (3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenue rather than as program revenue. Likewise, general revenue includes all taxes.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the City's policy is to first apply restricted resources.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the proprietary funds relates to charges to customers for sales and services. The Utility Services Fund also recognizes the portion of tap fees intended to recover current costs (e.g., labor and materials to hook up new customers) as operating revenue. The portion intended to recover the cost of the infrastructure is recognized as nonoperating revenue. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Assets, Liabilities, and Net Assets or Equity

Bank Deposits and Investments - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note I - Nature of Business and Significant Accounting Policies (Continued)

Receivables and Payables - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds." Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances."

All trade and property tax receivables are shown as net of allowance for uncollectible amounts.

Inventories and Prepaid Items - Inventories are valued at cost, on a first-in, first-out basis. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in both government-wide and fund financial statements.

Capital Assets - Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives:

Roads and sidewalks	10 to 15 years
Land improvements	5 to 75 years
Buildings and building improvements	10 to 30 years
Water and sewer distribution systems	12 to 75 years
Vehicles	5 years
Computer equipment	5 years
Office equipment	7 years
Office furnishings	7 years
Other tools and equipment	7 years

Infrastructure has only been recorded for projects that occurred subsequent to June 30, 2002. Retroactive infrastructure to 1980 will be reported prior to June 30, 2007.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note I - Nature of Business and Significant Accounting Policies (Continued)

Compensated Absences (Vacation and Sick Leave) - It is the City's policy to permit employees to accumulate earned but unused sick and vacation pay benefits. There is no liability for unpaid accumulated sick leave except for amounts accumulated by police and fire employees. Vacation pay for all employees and sick pay for police and fire employees is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only for employee terminations as of year end.

Long-term Obligations - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

Fund Equity - In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Comparative Data/Reclassifications - Comparative data is not included in the City's financial statements.

Property Tax Revenue

Property taxes are levied on each July 1 on the taxable valuation of property as of the preceding December 31. Taxes are considered delinquent on September 16, at which time penalties and interest are assessed.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

The City's 2005 tax is levied and collectible on July 1, 2005, and is recognized as revenue in the year ended June 30, 2006, when the proceeds of the levy are budgeted and available for the financing of operations.

The 2005 taxable valuation of the City totaled approximately \$131 million, on which taxes levied consisted of 17.9512 mills for operating purposes, 3.3613 mills for debt service, 1.0064 mills for Dial-A-Ride, 1.6103 mills for Permanent Public Improvement, and 2.1937 mills for police and fire pensions. This resulted in approximately \$2.4 million for operating, \$440,000 for debt service, \$132,000 for Dial-A-Ride, \$211,000 for Permanent Public Improvement, and \$290,000 for police and fire pensions. These amounts are recognized in the respective General, Special Revenue, Debt Service, and component unit financial statements as tax revenue.

Note 2 - Stewardship, Compliance, and Accountability

Construction Code Fees - The City oversees building construction, in accordance with the State's Construction Code Act, including inspection of building construction and renovation to ensure compliance with the building codes. The City charges fees for these services. The law requires that collection of these fees be used only for construction code costs, including an allocation of estimated overhead costs. A summary of the current year activity and the cumulative surplus or shortfall generated since July 1, 2005 is as follows:

Shortfall at July 1, 2005		\$	(385,062)
Current year permit revenue			46,339
Related expenses:			
Direct costs	\$	214,291	
Estimated indirect costs		<u>-</u>	<u>214,291</u>
Current year shortfall			<u>(167,952)</u>
Cumulative shortfall at June 30, 2006		\$	<u>(553,014)</u>

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 2 - Stewardship, Compliance, and Accountability (Continued)

Fund Deficits - The City has accumulated unreserved fund deficits in the following individual funds:

Fund	Balance
General Fund	\$ (3,265,368)
Special Revenue Funds:	
Major Streets	(143,157)
Local Streets	(551,044)
Federal and State Grants	(384,272)
Enterprise Fund - Cemetery	(171,525)
Component Unit - Brownfield Redevelopment Authority	(11,825)

Noncompliance with Budgeting Act - The City Commission did not adopt a budget for the Enterprise Zone Fund, a Major Special Revenue Fund, for the year ended June 30, 2006.

Deficit Reduction Plan - The City of Benton Harbor General Fund has a total deficit fund balance of \$2,830,016 for the year ended June 30, 2006 and has structured a five-year plan to reduce this deficit. This deficit reduction was included in the City's budget beginning in fiscal year 2006, and will continue to be included until the deficit is eliminated. Overall, the plan will seek to increase revenues and reduce costs while maintaining service levels. In addition, the City is looking at a reduction in normal expenditures by management controls and restructuring processes and procedures. The City hopes to achieve this through improved rubbish collections, land sales of beach-front property, sales of tax-reverted property, and property reassessments. The City looks to control expenditures through staff reductions and management/departmental oversight of cell phone usage and gasoline consumption, as well as other general costs.

Net Pension Obligation - The City did not contribute the total annual required contribution to the General Employees' Retirement System during fiscal 2006.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 3 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The pension trust funds are also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the trust fund's assets exceed \$250 million), debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The City has designated three banks for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 and has authorized investments as noted above. The City's deposits and investment policies are in accordance with statutory authority.

The City's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. At year end, the City had \$822,689 of bank deposits (certificates of deposit, checking and savings accounts) that were uninsured and uncollateralized. The City believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the City evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City does not have a policy for custodial credit risk. At year end, \$7,808,380 of investment securities was uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the City's name.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 3 - Deposits and Investments (Continued)

Concentration of Credit Risk - The City places no limit on the amount the district may invest in any one issuer. More than 5 percent of the City's investments are in the following investments:

Investment	Market Value	Percent of Total Market Value
JPMorgan Intrepid Mid Cap Fund Select Class (WOOPX)	\$ 1,177,077	7.3%
JPMorgan Core Bond Fund Select Class (WOBDX)	5,946,777	37.1%

Note 4 - Receivables

Receivables as of year end for the City's individual major funds and the nonmajor and fiduciary funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	General Fund	Enterprise Zone Fund	Nonmajor Funds	Utility Service	Component Units	Total
Receivables:						
Receivables from sales to customers on account	\$ 680,717	\$ -	\$ -	\$ 2,796,779	\$ -	\$ 3,477,496
Other receivables	-	-	-	175,000	208,127	383,127
Due from other governmental units	131,401	66,745	149,710	12,902	-	360,758
Notes	53,588	443,847	-	-	-	497,435
Less allowance for uncollectibles	(300,000)	-	-	(1,583,359)	-	(1,883,359)
Net receivables	<u>\$ 565,706</u>	<u>\$ 510,592</u>	<u>\$ 149,710</u>	<u>\$ 1,401,322</u>	<u>\$ 208,127</u>	<u>\$ 2,835,457</u>

Governmental funds report deferred revenue in connection with receivables for revenue that is not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received but not yet earned. At the end of the current fiscal year, the Enterprise Zone Fund reports deferred revenue as follows:

	Unavailable	Unearned
Long-term receivables	<u>\$ 443,847</u>	<u>\$ -</u>

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 5 - Capital Assets

Capital asset activity of the City's governmental and business-type activities was as follows:

	Balance July 1, 2005	Additions	Balance June 30, 2006
Governmental Activities			
Capital assets not being depreciated:			
Land	\$ 1,559,996	\$ -	\$ 1,559,996
Construction in progress	-	200,328	200,328
Airport land	1,932,908	-	1,932,908
Subtotal	3,492,904	200,328	3,693,232
Capital assets being depreciated:			
Roads and sidewalks	4,191,798	1,316,769	5,508,567
Airport depreciable property	9,112,065	-	9,112,065
Land improvements	552,244	25,360	577,604
Buildings and improvements	6,446,504	-	6,446,504
Vehicles	1,943,667	47,532	1,991,199
Computer equipment	627,131	4,000	631,131
Office equipment	501,728	-	501,728
Office furnishings	194,269	-	194,269
Other tools and equipment	1,901,835	43,308	1,945,143
Subtotal	25,471,241	1,436,969	26,908,210
Accumulated depreciation:			
Roads and sidewalks	337,512	211,553	549,065
Airport depreciable property	6,278,616	149,580	6,428,196
Land improvements	327,703	9,617	337,320
Buildings and improvements	2,312,495	247,323	2,559,818
Vehicles	1,742,724	51,751	1,794,475
Computer equipment	462,348	36,188	498,536
Office equipments	194,272	29,319	223,591
Office furnishings	185,552	2,491	188,043
Other tools and equipment	1,487,173	96,405	1,583,578
Subtotal	13,328,395	834,227	14,162,622
Net capital assets being depreciated	12,142,846	602,742	12,745,588
Net capital assets	\$ 15,635,750	\$ 803,070	\$ 16,438,820

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 5 - Capital Assets (Continued)

Business-type Activities	Balance July 1, 2005	Additions	Balance June 30, 2006
Capital assets not being depreciated - Land	\$ 6,736	\$ -	\$ 6,736
Capital assets being depreciated:			
Water and sewer distribution systems	8,295,819	424,240	8,720,059
Land improvements	68,285	31,500	99,785
Buildings and building improvements	2,348,583	88,567	2,437,150
Vehicles	376,702	20,354	397,056
Other tools and equipment	2,197,152	45,061	2,242,213
Subtotal	13,286,541	609,722	13,896,263
Accumulated depreciation:			
Water and sewer distribution systems	6,219,707	141,657	6,361,364
Land improvements	66,804	1,132	67,936
Buildings and building improvements	1,403,091	55,127	1,458,218
Vehicles	324,068	21,655	345,723
Other tools and equipment	1,948,874	75,836	2,024,710
Subtotal	9,962,544	295,407	10,257,951
Net capital assets being depreciated	3,323,997	314,315	3,638,312
Net capital assets	\$ 3,330,733	\$ 314,315	\$ 3,645,048

Depreciation expense was charged to programs of the primary government as follows:

Governmental activities:	
General government	\$ 142,135
Public safety	90,336
Public works	321,608
Economic development	75,266
Recreation and culture	204,882
Total governmental activities	\$ 834,227
Business-type activities:	
Water	\$ 239,778
Sewer	39,280
Cemetery	16,349
Total business-type activities	\$ 295,407

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 6 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

Receivable Fund	Payable Fund	Amount
Due to/from Other Funds		
General Fund	Utility Service Fund	\$ 1,145,696
	Nonmajor governmental funds	110,544
	Total General Fund	<u>\$ 1,256,240</u>
Advances from/to Other Funds		
General Fund	Nonmajor governmental funds	\$ 223,847
	Cemetery	157,917
	Total General Fund	381,764
Enterprise Zone Fund	General Fund	1,698,699
Debt Service Fund	General Fund	1,184,418
Nonmajor governmental funds	General Fund	532,694
	Nonmajor governmental funds	<u>563,293</u>
	Total nonmajor governmental funds	1,095,987
Utility Service Fund	Cemetery Fund	<u>34,758</u>
	Total	<u>\$ 4,395,626</u>

Interfund receivables are the result of timing differences in the transfer of funds to cover expenditures from shared bank accounts and grant funds where draws were received subsequent to the year when expenditures occurred. Interfund receivables that are not expected to be repaid within one year are classified as advances.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 6 - Interfund Receivables, Payables, and Transfers (Continued)

Interfund transfers reported in the fund financial statements are comprised of the following:

<u>Fund Providing Resources</u>	<u>Fund Receiving Resources</u>	<u>Amount</u>
Enterprise Zone Fund	General Fund	\$ 18,730
	Utility Service Fund	<u>418,840</u>
	Total Enterprise Zone Fund	437,570
Utility Service Fund	General Fund	18,145
Debt Service Fund	Utility Service Fund	<u>204,818</u>
	Total	<u>\$ 660,533</u>

The transfers from the Enterprise Zone Fund to the General and Utility Service Funds represent the use of restricted revenue sources for eligible expenditures; the transfer from the Utility Service Fund to the General Fund represents the sharing of leased equipment costs; and the transfer from the Debt Service Fund to the Utility Service Fund represents the movement of resources to be used to service water bond debt.

Note 7 - Capital Leases

Capital Leases - The City has entered into a lease agreement as lessee for financing the purchase of various pieces of equipment. This lease agreements qualify as capital leases for accounting purposes and, therefore, have been recorded at the present value of the future minimum lease payments as of the inception date. The future minimum lease obligations and the net present value are as follows:

<u>Years Ending June 30</u>	<u>Amount</u>
2007	\$ 162,696
2008	110,167
2009	52,455
2010	<u>17,499</u>
Total minimum lease payments	342,817
Less amount representing interest	<u>(24,222)</u>
Present value	<u>\$ 318,595</u>

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 8 - Long-term Debt

The City issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the City. County contractual agreements and installment purchase agreements are also general obligations of the government.

The City has the following long-term debt outstanding as of June 30, 2006:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Governmental Activities					
Core communities loan	\$ 200,000	\$ -	\$ -	\$ 200,000	\$ -
HUD Section 108 loan (Modern Plastics)	350,000	-	(200,000)	150,000	100,000
HUD Section 108 loan (Family Dollar)	50,000	-	-	50,000	-
HUD Section 108 loan (Spence Technology)	100,000	-	-	100,000	-
HUD Section 108 loan (other)	-	900,000	-	900,000	-
USDA note payable	80,000	-	(29,000)	51,000	-
Dump trucks	69,009	-	(23,593)	45,416	25,279
Photocopiers	89,142	-	(31,121)	58,021	32,583
Computers	65,969	-	(23,380)	42,589	32,631
Telephone system	174,867	-	(36,780)	138,087	38,834
Total	\$ 1,178,987	\$ 900,000	\$ (343,874)	\$ 1,735,113	\$ 229,327
Compensated absences	\$ 332,076	\$ 69,032	\$ -	\$ 401,108	\$ 340,942
Business-type Activities					
General obligations -					
1997 Water bonds	\$ 515,000	\$ -	\$ (180,000)	\$ 335,000	\$ 185,000
Note payable - Benton Township	-	1,247,406	-	1,247,406	434,037
Cemetery equipment	20,566	-	(9,575)	10,991	10,991
Photocopier	2,420	-	(825)	1,595	887
Pickup truck	-	25,216	(3,320)	21,896	6,485
Total	\$ 537,986	\$ 1,272,622	\$ (193,720)	\$ 1,616,888	\$ 637,400
Compensated absences	\$ 63,638	\$ 24,880	\$ -	\$ 88,518	\$ 84,092

Total interest expense for the year was approximately \$60,400. Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2007	\$ 100,000	\$ 5,113	\$ 105,113	\$ 637,400	\$ 15,830	\$ 653,230
2008	216,000	4,228	220,228	545,205	39,128	584,333
2009	417,000	3,504	420,504	414,727	12,336	427,063
2010	118,000	1,870	119,870	19,556	100	19,656
2011	150,000	1,643	151,643	-	-	-
2012-2015	450,000	2,044	452,044	-	-	-
Total	\$ 1,451,000	\$ 18,402	\$ 1,469,402	\$ 1,616,888	\$ 67,394	\$ 1,684,282

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 9 - Risk Management

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City has purchased commercial insurance for all of these various risks. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

Note 10 - Defined Benefit Pension Plan - General Employees' Retirement System

Plan Description - The City's General Employees' Pension Plan is a single-employer defined benefit pension plan that is administered by the City of Benton Harbor General Employees' Retirement System. This plan covers all appointed officers and employees of the City (except for personnel of the fire and police departments) and appointed officers and employees of the Southwest Michigan Regional Airport Authority. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. At July 1, 2005, the date of the most recent actuarial valuation, membership consisted of 40 retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them, and 77 current active employees. The plan does not issue a separate financial report.

Funding Policy - The obligation to contribute to and maintain the system for these employees was established by negotiation with the City's collective bargaining units and requires a contribution from the employees of 3 percent. The funding policy provides for periodic employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings.

Annual Pension Cost - For the year ended June 30, 2006, the City's annual pension cost of \$367,717 for the plan consisted of \$173,990 of contributions made, plus a net pension obligation of \$193,727; because this is the first year of underpayment, there was no interest added nor an adjustment to the ARC. The annual required contribution of \$367,717 was determined as part of an actuarial valuation at June 30, 2005, using the aggregate actuarial cost method. Significant actuarial assumptions used include (a) a 7.75 percent investment rate of return, (b) projected salary increases of 4 percent per year, and (c) no cost of living adjustments. Both (a) and (b) include an inflation component. The actuarial value of assets was determined using fair market values. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis, over 30 years.

Three-year Trend Information

	Fiscal Year Ended June 30		
	2004	2005	2006
Annual pension cost	\$ 93,006	\$ 125,617	\$ 367,717
Percentage of APC contributed	100.0 %	100.0 %	48.3 %

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 11 - Defined Benefit Pension Plan - Police and Fire Retirement System

Plan Description - The Police and Fire Pension Plan is a single-employer defined benefit pension plan that is administered by the City of Benton Harbor Police and Fire Employees Retirement System; this plan covers all full-time police and fire employees of the City. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. At July 1, 2004, the date of the most recent actuarial valuation, membership consisted of 60 retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them, and 34 current active employees. The plan does not issue a separate financial report.

Funding Policy - The obligation to contribute to and maintain the system for these employees was established by negotiation with the City's collective bargaining units and requires a contribution from the employees of 5 percent of gross wages for police employees and 6 percent of gross wages for fire employees. The funding policy provides for periodic employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings.

Annual Pension Cost - For the year ended June 30, 2006, the City's annual pension cost of \$215,240 for the plan was equal to the City's required and actual contribution. In addition, \$257,239 was funded by the tax levy described below and recorded as "property taxes" on the statement of changes in plan net assets. The annual required contribution was determined as part of an actuarial valuation at June 30, 2005, using the aggregate actuarial cost method. Significant actuarial assumptions used include (a) a 7.75 percent investment rate of return, (b) projected salary increases of 4 percent per year, and (c) 4 percent per year cost of living adjustments. Both (a) and (b) include an inflation component. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is 30 years.

On August 14, 1984, the Circuit Court for Berrien County ordered the City of Benton Harbor to pay off the then calculated \$2,597,299 unfunded liability over the next 30 years. The City must levy a sufficient additional millage on an annual basis to pay the portion of this 30-year amortization plus normal operating costs that are not covered under the general operating budget. As indicated above, during the year, \$257,239 was recorded as property tax revenue. Due to the age of this commitment, the actuary has not included this as a net pension obligation.

City of Benton Harbor, Michigan

Notes to Financial Statements June 30, 2006

Note 11 - Defined Benefit Pension Plan - Police and Fire Retirement System (Continued)

Three-year Trend Information

	Fiscal Year Ended June 30		
	2004	2005	2006
Annual pension cost (APC)	\$ 318,048	\$ 214,644	\$ 215,239
Percentage of APC contributed	100.0 %	100.0 %	100.0 %

Note 12 - Contingent Liabilities

The City is arbitrating several illegal discharge cases. In all of these cases, retroactive pay or pay adjustments may be required. Currently, the City is unable to presently predict the outcome of the range of potential loss, which may result from the disposition of these matters.

The City is also the defendant in various litigations involving wrongful death, challenges to various City ordinances, various real estate disputes, breach of contract, and violation of civil rights. The civil suits will likely be covered by the City's liability insurance.

City management considers the City's exposure under all suits to be immaterial. No provision for any loss has been made in the financial statements.

Required Supplemental Information

City of Benton Harbor, Michigan

Required Supplemental Information Budgetary Comparison Schedule - General Fund Year Ended June 30, 2006

	Original/Final Budget	Actual	Variance with Amended Budget
Revenue			
Property taxes	\$ 2,428,000	\$ 2,176,981	\$ (251,019)
Licenses and permits	113,000	64,857	(48,143)
Federal grants	374,028	430,191	56,163
State-shared revenue and grants	2,569,500	2,301,744	(267,756)
Other local donations	-	249,451	249,451
Other charges for services	628,100	531,730	(96,370)
Charges to other funds	175,000	175,000	-
Other fines and forfeitures	115,000	195,786	80,786
Investment income	50,000	5,832	(44,168)
Rental income	242,500	135,482	(107,018)
Other revenue:			
Cable franchise fees	42,000	45,035	3,035
Other miscellaneous income	74,000	106,310	32,310
Total revenue	6,811,128	6,418,399	(392,729)
Expenditures - Current			
General government:			
Mayor and commission	135,050	224,015	(88,965)
City manager	203,000	111,573	91,427
Finance	319,700	333,654	(13,954)
Purchasing/Risk management	-	587	(587)
General administration	645,500	458,520	186,980
Assessor	222,236	220,124	2,112
Aid to other agencies	119,500	92,297	27,203
Clerk	194,600	176,669	17,931
Elections	44,700	10,717	33,983
Buildings and grounds	303,381	373,471	(70,090)
City attorney	170,000	152,746	17,254
Personnel	126,523	120,836	5,687
City engineer	12,000	4,771	7,229
Public safety:			
Police	2,723,354	3,244,595	(521,241)
Fire	1,115,807	1,204,593	(88,786)
Building inspections	267,350	208,093	59,257
Public works:			
Department of public works	221,615	264,153	(42,538)
Rubbish disposal	550,000	605,758	(55,758)
Other public works activities	234,500	192,675	41,825
Community and economic development	171,655	225,223	(53,568)
Recreation and culture:			
Parks and recreation	70,500	129,221	(58,721)
Armory	25,000	47,557	(22,557)
Communications	60,000	40,101	19,899
Total expenditures	7,935,971	8,441,949	(505,978)

City of Benton Harbor, Michigan

Required Supplemental Information Budgetary Comparison Schedule - General Fund (Continued) Year Ended June 30, 2006

	Original/Final Budget	Actual	Variance with Amended Budget
Excess of Revenue Over (Under) Expenditures	\$ (1,124,843)	\$ (2,023,550)	\$ (898,707)
Other Financing Sources			
Sale of fixed assets	1,200,000	1,589,127	389,127
Transfers in	-	36,875	36,875
Total other financing sources	1,200,000	1,626,002	426,002
Net Change in Fund Balance	75,157	(397,548)	(472,705)
Fund Balance (Deficit) - Beginning of year	(2,432,468)	(2,432,468)	-
Fund Balance (Deficit) - End of year	<u>\$ (2,357,311)</u>	<u>\$ (2,830,016)</u>	<u>\$ (472,705)</u>

City of Benton Harbor, Michigan

Note to Required Supplemental Information Year Ended June 30, 2006

Budgetary Information - Annual budgets are adopted on a basis consistent with generally accepted accounting principles for the General Fund and most Special Revenue Funds except the Federal and State Grant Fund and the Enterprise Zone Fund. These funds are excluded from the budget statement. The annual budget is prepared by the City management and adopted by the City Commission. There were no budget amendments during the year. All annual appropriations lapse at fiscal year end and encumbrances are not included as expenditures.

The budget document presents information by fund, function, department, and line items. The legal level of budgetary control adopted by the governing body is the department level.

Amounts encumbered for purchase orders, contracts, etc. are not tracked during the year. Budget appropriations are considered to be spent once the goods are delivered or the services rendered.

Excess of Expenditures Over Appropriations in Budgeted Funds - During the year, the City of Benton Harbor incurred significant budget overruns, as follows:

	<u>Budget</u>	<u>Actual</u>
General Fund:		
Mayor and commission	\$ 135,050	\$ 224,015
Finance	319,700	333,654
Buildings and grounds	303,381	373,471
Police	2,723,354	3,244,595
Fire	1,115,807	1,204,593
Department of Public Works	221,615	264,153
Rubbish disposal	550,000	605,758
Community and economic development	171,655	225,223
Armory	25,000	47,557
Parks and recreation	70,500	129,221

City of Benton Harbor, Michigan

Required Supplemental Information General Employees' Retirement System Schedule of Funding Progress Year Ended June 30, 2006

The schedule of funding progress is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (a-b)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
6/30/00	\$ 6,674,675	\$ 5,245,864	\$ 1,428,811	127.2	\$ 2,506,666	n/a
6/30/01	6,167,942	5,541,517	626,425	111.3	2,533,613	n/a
6/30/02	6,253,841	6,173,546	80,295	101.3	2,610,223	n/a
6/30/03	6,436,460	6,276,034	160,426	102.6	2,592,799	n/a
6/30/04	6,548,522	6,569,423	(20,901)	99.7	2,805,811	0.7
6/30/05	6,698,508	8,360,324	(1,661,816)	80.1	2,576,165	64.5

The schedule of employer contributions is as follows:

Fiscal Year Ended	Actuarial Valuation Date	Annual Required Contribution *	Percentage Contributed
6/30/01	6/30/00	\$ -	100.0
6/30/02	6/30/01	-	100.0
6/30/03	6/30/02	97,228	100.0
6/30/04	6/30/03	93,006	100.0
6/30/05	6/30/04	125,617	100.0
6/30/06	6/30/05	367,717	48.3

* The required contribution is expressed to the City as a percentage of payroll.

City of Benton Harbor, Michigan

Required Supplemental Information Police and Fire Pension System Schedule of Funding Progress Year Ended June 30, 2006

The schedule of funding progress is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (a-b)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
6/30/98	\$ 10,089,128	\$ 9,030,330	\$ 1,058,798	111.7	\$ 1,515,908	n/a
6/30/00	10,856,074	10,811,520	44,554	100.4	1,346,128	(3.3)
6/30/01	10,004,228	11,672,480	(1,668,252)	85.7	1,351,244	123.5
6/30/02	10,210,869	12,109,175	(1,898,306)	84.3	1,231,468	154.1
6/30/03	10,235,411	11,884,761	(1,649,350)	86.1	1,349,989	122.2
6/30/04	10,184,702	14,548,269	(4,363,567)	70.0	1,439,856	303.1

The schedule of employer contributions is as follows:

Fiscal Year Ended	Actuarial Valuation Date	Annual Required Contribution *	Percentage Contributed
6/30/01	6/30/98	\$ 45,584	100.0
6/30/02	6/30/00	362,562	100.0
6/30/03	6/30/01	370,738	100.0
6/30/04	6/30/02	318,048	100.0
6/30/05	6/30/03	214,644	100.0
6/30/06	6/30/04	215,240	100.0

* The required contribution is expressed to the City as a percentage of payroll.

Other Supplemental Information

City of Benton Harbor, Michigan

Other Supplemental Information Combining Balance Sheet Nonmajor Governmental Funds June 30, 2006

	Special Revenue Funds				Capital Projects Fund	Total Nonmajor Governmental Funds
	Major Streets	Local Streets	Federal and State Grants	Total	Permanent Public Improvement	
Assets						
Cash and cash equivalents	\$ 5,895	\$ -	\$ 55,479	\$ 61,374	\$ 473	\$ 61,847
Advances to other funds	563,293	-	-	563,293	532,694	1,095,987
Due from other governmental units	99,891	32,097	17,722	149,710	-	149,710
Total assets	\$ 669,079	\$ 32,097	\$ 73,201	\$ 774,377	\$ 533,167	\$ 1,307,544
Liabilities and Fund Balances						
Liabilities						
Accounts payable	\$ 1,327	\$ -	\$ 323,477	\$ 324,804	\$ -	\$ 324,804
Due to other funds	-	-	110,544	110,544	-	110,544
Advances from other funds	223,847	563,293	-	787,140	-	787,140
Accrued liabilities and other	23,769	19,848	23,452	67,069	-	67,069
Total liabilities	248,943	583,141	457,473	1,289,557	-	1,289,557
Fund Balances (Deficits)						
Reserved for advances	563,293	-	-	563,293	532,694	1,095,987
Unreserved, reported in:						
Special Revenue Funds	(143,157)	(551,044)	(384,272)	(1,078,473)	-	(1,078,473)
Capital Projects Funds	-	-	-	-	473	473
Total fund balances (deficits)	420,136	(551,044)	(384,272)	(515,180)	533,167	17,987
Total liabilities and fund balances (deficits)	\$ 669,079	\$ 32,097	\$ 73,201	\$ 774,377	\$ 533,167	\$ 1,307,544

City of Benton Harbor, Michigan

Other Supplemental Information Combining Statement of Revenue, Expenditures, and Changes in Fund Balances Nonmajor Governmental Funds Year Ended June 30, 2006

	Special Revenue Funds				Capital Projects Fund	Total Nonmajor Governmental Funds
	Major Streets	Local Streets	Federal and State Grants	Total	Permanent Public Improvement	
Revenue						
Property taxes	\$ -	\$ -	\$ -	\$ -	\$ 157,626	\$ 157,626
Federal grants	-	-	1,092,495	1,092,495	-	1,092,495
State shared revenue and grants	622,323	194,381	24,610	841,314	-	841,314
Investment income	263	-	-	263	226	489
Other revenue - Other miscellaneous income	-	-	-	-	33,181	33,181
Total revenue	622,586	194,381	1,117,105	1,934,072	191,033	2,125,105
Expenditures - Current						
Public works	473,302	431,314	(386)	904,230	206,809	1,111,039
Community and economic development	-	-	1,058,243	1,058,243	3,033	1,061,276
Total expenditures	473,302	431,314	1,057,857	1,962,473	209,842	2,172,315
Net Change in Fund Balances	149,284	(236,933)	59,248	(28,401)	(18,809)	(47,210)
Fund Balances (Deficits) - Beginning of year	270,852	(314,111)	(443,520)	(486,779)	551,976	65,197
Fund Balances (Deficits) - End of year	<u>\$ 420,136</u>	<u>\$ (551,044)</u>	<u>\$ (384,272)</u>	<u>\$ (515,180)</u>	<u>\$ 533,167</u>	<u>\$ 17,987</u>

City of Benton Harbor, Michigan

Other Supplemental Information Combining Statement of Net Assets Fiduciary Funds June 30, 2006

	Pension Trust Funds		
	General Pension	Police/Fire Pension	Total Pension Trust Funds
Assets			
Cash and cash equivalents	\$ 18,417	\$ 2,538	\$ 20,955
Investments:			
Mutual funds	3,123,343	5,138,929	8,262,272
U.S. government securities	351	351	702
Corporate securities	2,805,857	4,531,684	7,337,541
Foreign stocks	160,538	259,846	420,384
Receivables	613,896	295,570	909,466
Accrued interest receivable	13,712	22,461	36,173
Total assets	6,736,114	10,251,379	16,987,493
Liabilities - Due to resigned employees	5,007	1,182	6,189
Net Assets Held in Trust for Pension Benefits	\$ 6,731,107	\$ 10,250,197	\$ 16,981,304

City of Benton Harbor, Michigan

Other Supplemental Information Combining Statement of Changes in Fiduciary Net Asset Fiduciary Funds Year Ended June 30, 2006

	General Pension	Police/Fire Pension	Total
Additions			
Investment income:			
Interest and dividends	\$ 391,597	\$ 634,524	\$ 1,026,121
Net increase in fair value of investments	13,642	23,309	36,951
Net investment income	405,239	657,833	1,063,072
Contributions:			
Employer	173,990	215,240	389,230
Employee	96,591	118,997	215,588
Total contributions	270,581	334,237	604,818
Property taxes	-	257,239	257,239
Total additions	675,820	1,249,309	1,925,129
Deductions			
Benefit payments	297,665	876,015	1,173,680
Administrative expenses	27,354	36,708	64,062
Total deductions	325,019	912,723	1,237,742
Net Increase in Net Assets Held in Trust	350,801	336,586	687,387
Net Assets Held in Trust for Pension Benefits - Beginning of year	6,380,306	9,913,611	16,293,917
Net Assets Held in Trust for Pension Benefits - End of year	<u>\$ 6,731,107</u>	<u>\$ 10,250,197</u>	<u>\$ 16,981,304</u>

CITY OF BENTON HARBOR, MICHIGAN

**FEDERAL AWARDS
SUPPLEMENTAL INFORMATION**

YEAR ENDED JUNE 30, 2006

CITY OF BENTON HARBOR, MICHIGAN

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INDEPENDENT AUDITORS' REPORT

Honorable Mayor and
Members of the City Commission
City of Benton Harbor, Michigan

We have audited the basic financial statements of the City of Benton Harbor, Michigan for the year ended June 30, 2006 and have issued our report thereon dated January 26, 2007. Those basic financial statements are the responsibility of the management of the City of Benton Harbor, Michigan. Our responsibility was to express an opinion on those basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was made for the purpose of forming an opinion on the basic financial statements of the City of Benton Harbor, Michigan taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purpose of additional analysis as required by U.S. Office of Management and Budget (OMB) Circular A-133 "Audits of States, Local Governments, and Non-Profit Organizations," and is not a required part of the basic financial statements. The information in this schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Alan C. Young & Assoc.

January 26, 2007

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Honorable Mayor and
Members of the City Commission
City of Benton Harbor, Michigan

We have audited the financial statements of the City of Benton Harbor, Michigan as of and for the year ended June 30, 2006, and have issued our report thereon dated January 26, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the City of Benton Harbor, Michigan's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City of Benton Harbor, Michigan's ability to initiate, record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable conditions are described in the accompanying schedule of findings and questioned costs as financial statement audit findings 06-1 thru 06-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Report on Internal Control over Financial Reporting
And on Compliance and Other Matters Based on an
Audit of Financial Statements Performed
In Accordance with Government Auditing Standards
(Continued)

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a reportable condition, and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable conditions in items 06-1 and 06-2 to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the City of Benton Harbor, Michigan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of the City of Benton Harbor, Michigan in a separate letter dated January 26, 2007.

This report is intended solely for the information and use of the City Commission, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Alan C. Young; Assoc.

January 26, 2007

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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

To the Honorable Mayor and
Members of the City Commission
City of Benton Harbor, Michigan

Compliance

We have audited the compliance of the City of Benton Harbor, Michigan with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. The major federal programs of the City of Benton Harbor, Michigan are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Benton Harbor, Michigan's management. Our responsibility is to express an opinion on the City of Benton Harbor, Michigan's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *"Audits of States, Local Governments, and Non-Profit Organizations."* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Benton Harbor, Michigan's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City of Benton Harbor, Michigan's compliance with those requirements. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A – 133 and which are described in the accompanying schedule of findings and questioned costs as items 06-3 thru 06-6.

In our opinion, except for the noncompliance described in the preceding paragraph, the City of Benton Harbor, Michigan complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.

Report on Compliance with Requirements Applicable
to each Major Program and Internal Control over Compliance
in accordance with OMB Circular A-133
(Continued)

Internal Control over Compliance

The management of the City of Benton Harbor, Michigan is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of Benton Harbor, Michigan's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A – 133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the City of Benton Harbor, Michigan's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-3 thru 06-6.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error and fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable conditions in items 06-3 thru 06-6 to be material weaknesses.

This report is intended solely for the information of City Commission, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Alan C. Young, Assoc.

January 26, 2007

CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2006

<u>FEDERAL AGENCY/PASS THROUGH AGENCY PROGRAM TITLE</u>	<u>CFDA NUMBER</u>	<u>FEDERAL EXPENDITURES</u>
<u>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</u>		
Community Development Block Grant		
B-04-MC-26-0035	14.218	\$366,514
B-05-MC-26-0035	14.218	313,837
B-06-MC-26-0035	14.218	2,722
Brownfield Economic Development	14.248	301,824
Total U.S. Department of Housing and Urban Development		984,897
<u>U.S. DEPARTMENT OF JUSTICE</u>		
Community Oriented Policing Service		
COPS in School	16.710	385,673
Secure Our School	16.710	60,939
Local Law Enforcement Block Grant	16.592	19,298
PASSED-THROUGH STATE OF MICHIGAN-DEPARTMENT OF COMMUNITY HEALTH		
BYME/JAG Formula Grant	16.738	7,500
PASSED-THROUGH STATE OF MICHIGAN-DEPARTMENT OF STATE POLICE	16.523	15,375
Total U.S. Department of Justice		488,785
<u>U.S. ENVIRONMENTAL PROTECTION AGENCY</u>		
Surveys-Studies-Investigations and Special Purpose Grant	66.606	418,840
<u>U.S. DEPARTMENT OF HOMELAND SECURITY</u>		
Training Grant	97.004	8,255
Federal Emergency Management Administration	97.036	3,927
Total U.S. Department Homeland Security		12,182
TOTAL FEDERAL EXPENDITURES		\$1,904,704

See notes to schedule of expenditures of federal awards.

**CITY OF BENTON HARBOR
RECONCILIATION OF BASIC FINANCIAL STATEMENTS
FEDERAL REVENUE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2006**

Federal Revenue Reported in the Basic Financial Statements	\$ 2,072,122
Less: Prior Year Deferred Revenue Received in Advance of Spending	<u>(167,418)</u>
Federal Expenditures per the Schedule of Expenditures of Federal Awards	<u>\$ 1,904,704</u>

**CITY OF BENTON HARBOR, MICHIGAN
NOTES TO SCHEDULE OF EXPENDITURES
OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2006**

1) SIGNIFICANT ACCOUNTING PRINCIPLES

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the City of Benton Harbor, Michigan and is presented on the same basis of accounting as the basic financial statements. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of State, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

2) EXPENDITURE REPORTS

Management has reconciled the expenditures reported in the Schedule of Expenditures of Federal Awards to those amounts reported in the annual final cost reports. Unallowable differences, if any, have been disclosed to the auditor

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006**

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? X Yes No
- Reportable condition(s) identified that are not considered to be material weaknesses? X Yes No
- Non-Compliance material to financial Statements noted? Yes X No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? X Yes No
- Reportable condition(s) identified that are not considered to be material weakness? X Yes No

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?

 X Yes No

Identification of major programs:

CFDA Numbers	Name of Federal Program or Cluster
14.218	Community Development Block Grant
16.710	COPS in School
66.606	Special Appropriation Project

Dollar threshold used to distinguish between type A and B programs: \$300,000

Auditee qualified as low risk auditee? Yes X No

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006**

SECTION II – FINANCIAL STATEMENT AUDIT FINDINGS

Reference Number	Findings
06-1	<p>Finding Type – Reportable Condition and Material Weakness</p> <p>Condition – The City did not prepare timely bank reconciliations for significant accounts during a significant portion of the year.</p> <p>Description – In order to maintain adequate internal control, timely reconciliation of bank accounts should be prepared. We recommend that timely bank reconciliations be prepared in the future.</p> <p>Questioned Costs – None</p>

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006
(Continued)**

SECTION II – FINANCIAL STATEMENT AUDIT FINDINGS

Reference Number	Findings
06-2	<p>Finding Type – Reportable Condition and Material Weakness</p> <p>Condition – During our testing of internal controls over cash disbursements, we found that the City is not consistently applying its own policies. Out of a sample of 86 disbursements tested, we noted that invoice packets for 17 items were not available and 6 cancelled checks were not available. This is a repeat finding from 2005.</p> <p>Description – This condition creates the risk that disbursements may be made improperly and not be detected by management. We recommend that management ensure that invoices and other supporting documents, along with the cancelled checks are available for all cash disbursements.</p> <p>Questioned Costs – None</p>

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006
(Continued)**

SECTION III – FEDERAL PROGRAM AUDIT FINDINGS

Reference Number	Findings
06-3	<p>Program Name – Community Development Block Grant; CFDA #14.218.</p> <p>Finding Type – Material noncompliance, Reportable Condition, and Material Weakness.</p> <p>Criteria – The City is required to verify certification that vendors have not been suspended or debarred from federal procurement for any contracts greater than \$25,000.</p> <p>Condition – The City did not demonstrate certification that a vendor was not suspended or debarred had been verified prior to the contract being awarded.</p> <p>Questioned Costs – None. The City was subsequently able to determine that the contractor was not debarred from federal procurement participation.</p> <p>Cause/Effect – The City could have employed a vendor that was suspended or debarred from federal grant participation.</p> <p>Recommendation – The City should implement a procedure to ensure that all vendors used with contracts greater than \$25,000 have suspension and debarment certifications on file with the City.</p>

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006
(Continued)**

SECTION III – FEDERAL PROGRAM AUDIT FINDINGS (Continued)

Reference Number	Findings
06-4	<p>Program Name – U.S. Department of Justice-Community Oriented Policing Services- Secure Our School Program; CFDA # 16.710.</p> <p>Finding Type – Material Noncompliance, Reportable Condition, and Material Weakness.</p> <p>Criteria – The City is required to verify certification that vendors have not been suspended or debarred from federal procurement for any contracts greater than \$25,000.</p> <p>Condition – The City did not demonstrate certification that a vendor was not suspended or debarred had been verified prior to contract being awarded.</p> <p>Questioned Costs – None.</p> <p>Cause/Effect – The City could have employed a vendor that was suspended or debarred from federal grant participation.</p> <p>Recommendation – The City should implement a procedure to ensure that all vendors used with contracts greater than \$25,000 have suspension and debarment certifications on file with the City.</p>

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006
(Continued)**

SECTION III – FEDERAL PROGRAM AUDIT FINDINGS (Continued)

Reference Number	Findings
06-5	<p>Program Name – U.S. Department of Justice-Community Oriented Policing Services; CFDA # 16.710.</p> <p>Finding Type – Material Noncompliance, Reportable Condition, and Material Weakness.</p> <p>Criteria – The City is required to submit quarterly Financial Status Reports to the Granting Agency within 30 days of the end of the quarter.</p> <p>Condition – The City did not submit the required FSRs in time for the Secure our School program. Further several of the FSRs did not match the actual expenditure for the respective quarters.</p> <p>Questioned Costs – None.</p> <p>Cause/Effect – The City could lose Federal funding due to the submission of inaccurate and non-timely FSRs.</p> <p>Recommendation – The City should implement a procedure to ensure that all the required FSRs are properly completed, reviewed and submitted within the stipulated time frame.</p>

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2006
(Continued)**

SECTION III – FEDERAL PROGRAM AUDIT FINDINGS (Continued)

Reference Number	Findings
06-6	<p>Program Name – U.S. Environmental Protection Agency-Special Appropriations Project; CFDA # 66.606</p> <p>Finding Type – Material Noncompliance, Reportable Condition, and Material Weakness.</p> <p>Criteria – The City is required to submit quarterly MBE/WBE reports to the granting Agency within 30 days of the end of the quarter, semi-annual technical performance reports within 30 days following the end of each six-month period, and an Environmental Results-Recipient Performance Report.</p> <p>Condition – The City did not submit the required reports as noted above.</p> <p>Questioned Costs – None.</p> <p>Cause/Effect – The City could lose federal funding due to the non-submission of the required reports.</p> <p>Recommendation – The City should implement a procedure to ensure that all the required reports are properly prepared, reviewed and submitted within the stipulated time frame.</p>

**CITY OF BENTON HARBOR, MICHIGAN
SCHEDULE OF FINDING AND QUESTIONED COSTS
STATUS OF PRIOR YEAR FINDINGS
YEAR ENDED JUNE 30, 2006**

STATUS OF PRIOR YEAR FINDINGS

Reference Number	Findings
Finding 05-1	Internal Controls Over Cash Disbursements Condition – It was found that the City was not consistently applying its own policies. Out of a sample of 212 disbursements tested, it was noted that 80 items were missing check requests, posting instructions, and/or authorizing signatures. This condition created the risk that disbursements may be made improperly and not be detected by management. Status: We found that the condition as noted above has continued for the financial year ended June 30, 2006. Out of 86 samples tested for the year, the City did not make available invoices/supporting documents for 17 disbursements for our review. Further, cancelled checks for 6 disbursements were not made available for our review. See Finding 06-2.

Reference Number	Findings
Finding 05-2	HUD-Community Development Block Grant- Allowable Costs Condition – It was noted that approximately 23% of the disbursements were missing one or more required elements of internal approval. Status: For the sample tested, all disbursements appeared to be supported by necessary invoices/other supporting documents. However, out of a sample of 10, the cancelled check for one disbursement was not made available for our review.

**Alan C.
Young & Associates, P.C.**
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January 26, 2007

Honorable Mayor and
Members of the City Commission
City of Benton Harbor
175 Territorial
Benton Harbor, MI 49022

We have audited the basic financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Benton Harbor, Michigan, (the City), for the year ended June 30, 2006, and have issued our report thereon dated January 26, 2007.

In planning and performing our audit of the basic financial statements of the City for the year ended June 30, 2006, we considered the City's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of this report.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. We will review the status of these comments during our next audit engagement. These comments and recommendations, all of which have been discussed with the appropriate members of the management, are intended to improve internal control or result in other operating efficiencies and are summarized in Appendix A.

Our audit procedures are designed primarily to enable us to form opinions on the basic financial statements, and therefore may not bring to light all weaknesses in policies and procedures that may exist. We aim, however, to use our knowledge of the City's organization gained during our work to make comments and suggestions that we hope will be useful to you.

This letter is intended solely for the information of officials of the City of Benton Harbor, management, and others within the City. However, this letter is a matter of public record, and its distribution is not limited.

Sincerely,



Alan C. Young & Associates, P.C.
Certified Public Accountants

OVERALL FINANCIAL CONDITION

As management is keenly aware, the City has been experiencing some extremely tough economic times. Despite having placed a deficit elimination plan in effect (as disclosed in Note 2 to the financial statements), the City has a total deficit fund balance of \$2.8 M for the year ended June 30, 2006. In addition, the City reported fund deficits totaling \$935,316 in two other funds. On a full accrual perspective, the City's combined governmental activities reported an unrestricted deficit in net assets of \$4.7 million.

The City management needs to critically review its budgeted fund balance positions and cash flow availability to evaluate the likelihood of meeting its initial budgeted targets. The analysis should include a detailed assessment of the primary revenue sources such as taxes, state shared revenue, permit fees and court fines and expenditures such as labor costs including pension and healthcare obligations including the level of citizens' services planned versus what can be afforded. City management has indicated that this financial review is an ongoing and continuous process.

PERIODIC ACCOUNT ANALYSES

The City has not been performing monthly account analysis or reconciliations for many of its balance sheet accounts. Our review of the general ledger revealed that a significant effort was undertaken at year end to substantially adjust the City's accounting records to present information in accordance with generally accepted accounting principles.

While we were ultimately satisfied that the amounts presented in the City's audited financial statements were fairly presented in all material respects, the significant amount of corrections required at year end underscores that the interim financial data available to City management is not materially accurate or reliable.

One of the best internal control procedures for verifying the accuracy of the City's financial information through out the year is the periodic analysis of account balances (particularly for balance sheet accounts) to ascertain the following:

- Balance sheet accounts are supported by itemized listings of the components comprising the financial statement totals;
- The detail listing is free of obvious errors, unusual reconciling items that suggest the need for adjustment, and mispostings or other clerical errors;
- The balances make sense relative to operational data.

Accordingly, we recommend that all balance sheet accounts be analyzed monthly. The analysis should be retained and reviewed by a responsible official other than the preparer as part of the monthly closing cycle. This procedure will provide improved assurance that accounting errors will be detected and corrected in a timely manner, and will provide management and the City Commission more meaningful and useful financial data with which to make their decisions.

REFUNDING OF EMPLOYEE CONTRIBUTIONS TO THE PENSION SYSTEM

Our review of the City's liability accounts revealed some rather old balances owed to terminated employees. When an employee leaves the City, he or she is entitled to a refund of any employee contributions made to the retirement system. However, under the City's current operating procedure, these amounts are only disbursed upon specific request of the employee.

We recommend that the City provide each employee with the necessary paperwork to request a distribution of employee contributions to the pension system at the time of separation from the City. If an employee does not file a request for these funds within a reasonable timeframe, such amounts should be escheated in accordance with the state law.

UTILITY SERVICES

The City tracks billing and collection for each municipality (City of Benton Harbor, Benton Township, St. Joseph Township and Hager Township.) During our audit procedures, we noted that the City revised its Water & Sewerage rate based on the Council's decision. However these rates were not updated by the utility department in timely manner and hence as a result St. Joseph customers were unbilled for a certain period of time.

We recommend that any changes in billing be immediately informed to and updated by the respective department and that there should be independent verification of the factors entered into the system. This will ensure that the billings to the customers are correctly computed.

BANK RECONCILIATIONS

During our procedures, we noted that at year-end the City was not current with their Bank reconciliations. This situation also created difficulties in balancing the interfund due to / due from accounts due to interrelationship with cash allocation between funds. A significant effort was made by the City to rectify this situation, and when the audit started in January, 07, all bank accounts were properly reconciled, and the inter fund accounts were in balances.

Timely and accurate bank reconciliations are the cornerstone of any effective system of internal control. Bank reconciliations should be done on a timely basis. There should be an independent review of the reconciliation and the reconciling items on a regular basis.

DOCUMENT RETENTION

During our testing of internal controls over cash disbursements, we found that the City is not consistently applying its own policies. Out of a sample of 86 disbursements tested, we noted that invoice packets for 17 items were not available and 6 cancelled checks were not available.

We recommend that management ensure that invoices and other supporting documents, along with the cancelled checks are available for all cash disbursements.

SUSPENSION AND DEBARMENT

During our examination of compliance with grant requirements, we noted that for the year ended June 30, 2006, the City did not appear to have a procedure in place to verify that contractors utilized in the grants are not debarred from federally funded projects.

The City should implement a procedure to ensure that all vendors used with contracts greater than \$25,000 have suspension and debarment certifications on file with the City.